



# Expect More Robust PCAOB Enforcement This Year

By Robert Cox and Steven Richards – Republished with Permission from LAW360

**February 9, 2022** Challenges related to COVID-19 continued for almost everyone in 2021, including the Public Company Accounting Oversight Board’s Division of Enforcement and Investigations, or DEI.

In our Law360 guest article last year, “PCAOB Enforcement Scorecard Informs on Future Priorities,” we noted that “COVID challenges appear to be a principal reason for a 30% decrease in the number of settled orders in 2020 from 2019.”

In 2020, the PCAOB made 17 settled orders public,<sup>[1]</sup> compared with 30 settled orders in 2019.<sup>[2]</sup> This was the fewest number of settled orders made public by the PCAOB since 2013, when 13 settled orders were issued.

In 2021, the PCAOB made 21 settled orders public, slightly higher than in 2020.<sup>[3]</sup> The substantial decline in enforcement activity drew the attention of U.S. Securities and Exchange Commission Commissioner Allison Herren Lee in her Dec. 15, 2021, statement on the PCAOB’s 2022 budget.

Lee noted that in recent years,

*[W]e’ve seen enforcement cases drop by approximately two-thirds, the number of inspection reports issued since 2018 fall to just over half of prior levels (a big drop even considering Covid-related travel restrictions), and dozens of audit standards in need of modernization.<sup>[4]</sup>*

While COVID-19 challenges likely had an impact on 2021 enforcement activity, the change in presidential administrations and corresponding changes in leadership at the SEC and PCAOB may also have hampered the board’s ability to consider and approve settled orders.

With four new members of the board, including a new chair, who appear to be more in step with the progressive enforcement goals of SEC Chairman Gary Gensler and SEC Enforcement Director Gurbir Grewal, and a budget increase of 8% in 2022, we expect more robust inspections and enforcement activity in 2022.<sup>[5]</sup> However, with the exception of a new emphasis on accounting firms’ systems of quality control, we expect that PCAOB enforcement priorities will remain the same for:

- Significant audit violations;
- Cross-border audits;
- Foreign auditors;
- Engagement quality reviews; and
- Compliance with PCAOB rules, such as alteration of work papers, noncooperation with inspections or enforcement investigations, and failure to timely file Form 3 and Form AP.

Some key takeaways from the 2021 settled orders are:

- Continued focus on cross-border audits and non-U.S. firms — seven orders involved foreign auditors; and
- New focus on quality control violations.

## Transition in Board Members

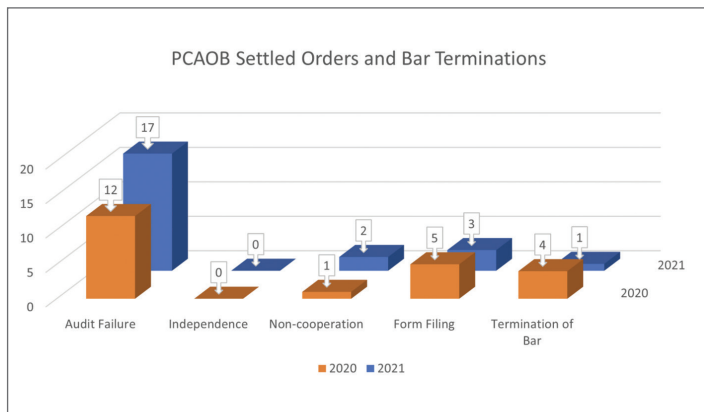
January 2021 began with the resignation of board member Robert Brown. For the next five months, the board operated with four members until June when Gensler announced the dismissal of board Chair William Duhnke and appointment of board member Duane DesParte as interim chair.

In late August, remaining board members Rebekah Goshorn Jurata and Megan Zietsman jointly announced they would resign by Oct. 1. For several weeks, the board operated with one board member until the Nov. 9, 2021, swearing-in of Christina Ho and Nov. 18, 2021, swearing-in of former SEC Commissioner Kara Stein. In January 2022, the new board Chair Erica Williams and board member Anthony Thompson were sworn in to bring the board to full capacity.

### 2021: By the Numbers

The challenges present in 2021 are partially reflected in the relatively similar number of settled orders in 2021 from 2020. In 2021, the PCAOB made 21 settled orders public, compared with 17 settled orders in 2020. This was slightly higher than 2020, when the fewest number of settled orders were made public by the PCAOB since 2013, when 13 settled orders were issued.

The chart below illustrates the categories of settled orders and bar terminations in 2020 and 2021. For simplicity's sake, we have used the following categories: audit failures, independence, noncooperation, form filing and terminations of bars.



*Note: Settled orders may be classified in more than one category.*

Many of the 21 orders involved long-standing enforcement priorities, including significant audit violations, cross-border audits, foreign auditors, engagement quality reviews, and compliance with PCAOB rules such as noncooperation with board inspectors and Form AP, Auditor Reporting of Certain Audit Participants.

However, 2021 revealed a new enforcement focus on the audit firm's compliance with the board's quality control standards. In fact, three of the most significant orders of 2021 in terms of the amount of the civil money penalty — KPMG Australia, Deloitte Canada and Haskell & White

LLP — all involved firms' violation of PCAOB quality control standards.<sup>[6]</sup>

The following are a few key takeaways we believe are worth mentioning.

### Quality Control

Quality control is a new enforcement priority. PCAOB quality control standards require a registered firm have a system of quality control, including policies and procedures that provide reasonable assurance that the work performed by engagement personnel meets applicable professional standards, regulatory requirements and the firm's standards of quality.

PCAOB inspectors have been increasingly focused on accounting firm's quality control systems, and 2021 saw a substantial increase in enforcement in this area.

In 2021, the board sanctioned several accounting firms, mostly foreign firms, for quality control violations. Two of the firms, Haskell & White and Deloitte Canada, were sanctioned for quality control violations related to the preparation of audit documentation and timely archiving of that documentation.

In an order involving the imposition of the largest civil money penalty of the year, \$450,000, the board sanctioned KPMG's Australian affiliate for failing to establish appropriate quality control policies and procedures for administering and monitoring training tests.<sup>[7]</sup> The quality control failures prevented KPMG Australia from identifying that more than 1,100 personnel, including more than 250 of its auditors, were involved in improper answer sharing in connection with tests for mandatory training courses.

One required element of a quality control system is monitoring. In 2021, several orders involved firms — e.g., Deloitte Canada, WDM Chartered Professional Accountants, Haskell & White — who were aware of deficiencies in their quality control systems monitoring procedures and failed to make changes to improve their systems of quality control.

In the second-largest order by civil money penalty, \$350,000, the board sanctioned Deloitte's Canadian affiliate for failing to monitor and take sufficient steps to address a risk that firm personnel could override a new electronic work paper system to backdate work paper signoffs.

Over a 16-month period, Deloitte Canada's personnel overrode the system and backdated their work paper signoffs in at least six issuer audits and two quarterly

reviews. In another order, the board sanctioned WDM, a Canadian firm, and the managing partner, Mike Kao, for failing to use an audit methodology designed to comply with PCAOB standards and rules, provide technical training, and perform internal monitoring procedures.<sup>[8]</sup>

In a matter involving a firm's disregard of the finding of its own internal inspections, the board sanctioned Haskell for failing to timely make changes or improve compliance with its system of quality control.<sup>[9]</sup> Annually, Haskell's quality control personnel performed internal inspections of Haskell's audit practice. Over a four-year period, Haskell's internal inspections identified numerous instances where engagement teams did not timely archive audit work papers as required by AS 1215.

These findings were reported to Haskell's entire audit department and all principal and partners, including the managing partner. Despite its awareness of these significant problems, Haskell failed to adequately monitor compliance with its quality control policies and procedures and failed to timely make changes or improve compliance with those procedures and policies.

#### **Objectivity and EQRs**

As in 2020, the board continued to expand its sanctioning of engagement quality reviewers, or EQRs. Initially, the board issued sanctions in instances where an engagement quality review was not performed. More recently, sanctions have included situations where the engagement quality reviewer failed to use due professional care when conducting their review, particularly while reviewing the engagement team's significant judgments.

In four orders, the board sanctioned engagement quality reviewers for failing to perform engagement quality reviews with due professional care.

In the issuer context, the board sanctioned an EQR, Donald R. Burke, for failing to comply with the applicable EQR standard — AS No. 7, Engagement Quality Review — for failing to exercise due professional care, including professional skepticism, because the EQR failed to properly evaluate the significant judgments made by the engagement team relating to engagement planning concerning revenue and the engagement teams' assessment of, and audit responses to, significant risks identified by the engagement team, including fraud risks.<sup>[10]</sup>

In another matter involving an issuer audit, the board sanctioned Stanley R. Langston for providing his concurring approval of issuance of Turner Stone & Company LLP's audit reports without performing the

engagement quality reviews with due professional care by failing to properly evaluate the significant judgments made by the engagement teams with respect to unrecorded or undisclosed related party transactions that were identified as fraud risks.<sup>[11]</sup>

In the broker-dealer context, the board sanctioned two firms, Morey Nee Buck & Oswald LLC and Tamba S. Mayah CPA, for violations of AS 1220, Engagement Quality Review.<sup>[12]</sup>

#### **Cross-Border Audits and Non-U.S. Firms**

The PCAOB continues to focus on non-U.S. firms. Seven of the orders involved foreign firms or individuals: five from Canada — Dale Matheson Carr-Hilton LaBonte LLP, Harbourside CPA LLP, WDM, Deloitte, and Morgan & Company LLP; one from Singapore — Tan Joon Wei, manager at KPMG's Singapore affiliate; and one from Australia — KPMG Australia.

Many of the orders involved firms' violations of PCAOB quality control standards. One of the orders involved a cross-border audit where Morgan & Company, a Canadian firm, used the work of a Mexican firm not registered with the PCAOB to support its opinion on an issuer's financial statements.<sup>[13]</sup>

The Mexican firm personnel were not trained in Canadian Auditing Standards or PCAOB standards, and in fact, performed its procedures in accordance with Mexican Auditing Standards.

#### **Compliance With PCAOB Rules**

The PCAOB continues to focus on firms whose conduct undermines oversight. In 2020, the PCAOB issued multiple orders for firms that failed to timely file Form 3 in accordance with PCAOB Rule 2203, Special Reports.<sup>[14]</sup> In 2021, the board sanctioned three firms, Slack & Company LLC, Harbourside CPA LLP, and SS Accounting and Auditing Inc., for violating PCAOB Rule 3211, Auditor Reporting of Certain Audit Participants, by failing to timely file Form AP, Auditor Reporting of Certain Audit Participants.<sup>[15]</sup>

Form APs are due by the 35th date after the date the audit report is first included in a document filed with the SEC.

Consistent with past practice, the board issued an order sanctioning a manager at KPMG Singapore, Tan Joon Wei, in a cross-border audit for failing to cooperate with a board inspection by modifying four work papers to add descriptions of audit procedures that were included in binders provided to board inspectors and preparing

a form that inspectors had asked the firm to complete in advance of fieldwork on behalf of the firm making a misleading statement to board inspectors that no changes had been made to the work papers.<sup>[16]</sup>

We offer the following points for consideration as we move through 2022.

### Changing of the Guard Likely to Lead to a More Vigorous PCAOB Enforcement Program in 2022

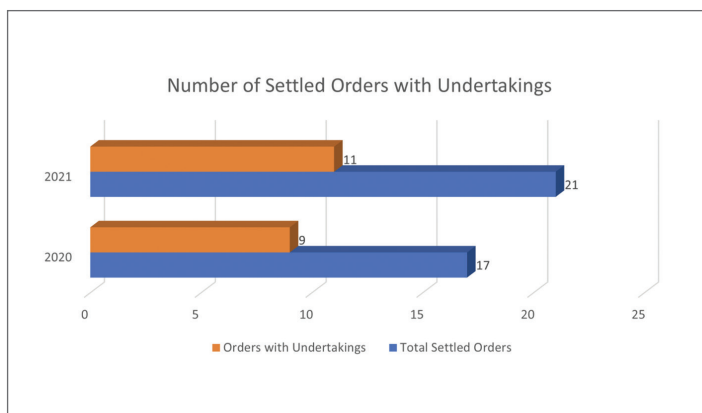
DEI will continue its focus on significant audit failure cases, cross-border audits (international), and audit integrity (alteration and backdating of work papers) — all of which have been a focus for more than five years.

In addition, we expect that the board will continue to employ remedial measures such as the appointment of monitors, requiring firms to change quality control policies and procedures, and requiring firms to provide additional professional education and training to personnel.

### Sanction Structure

Typically, the board uses a combination of censures, bars, and monetary penalties as sanctions in its matters.

However, the board also employs the use of suspensions and limitations depending on the nature of the matter. In more recent years, however, the board seems to have an interest in flexing its sanctioning muscle by incorporating remedial measures including undertakings and use of independent consultants by firms.<sup>[17]</sup>



Given the expected uptick in enforcement activity in the coming year, it seems likely these additional measures will continue to be tools in the PCAOB’s enforcement toolbox.

### Conclusion

Overall, in 2022, we expect more robust PCAOB enforcement efforts. DEI will continue to focus on significant audit failures, quality control, audit integrity and compliance.

In addition, DEI will continue to apply heightened scrutiny to non-U.S. firms, based on a belief that non-U.S. firms’ systems of quality control and competence of their auditors are not at the same level as the U.S.-based firms.

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## Notes

- [1] PCAOB also announced four orders terminating a bar of an accountant which are not included in the 17 settled disciplinary orders. See *In re David J.C. Cutler, CPA*, PCAOB Rel. No. 105-2020-001 (Jan. 15, 2020), *re Joao Rafael Belo de Araujo Filho*, PCAOB Rel. No. 105-2020-005 (Jun. 5, 2020), *re Raydell Stevenson, CPA*, and *Wesley H. Hufford, CPA*, PCAOB Rel. No. 105-2020-006 (Jun. 10, 2020), and *re Patrick Tarvaran, CPA*, PCAOB Rel. No. 105-2020-007 (Jun. 29, 2020).
- [2] No adjudicated orders were made public in 2019, 2020, or 2021.
- [3] PCAOB also announced an order terminating a bar of an accountant which is not included in the 21 settled disciplinary orders. See *In re Juan Martin Gudi o Casillas*, PCAOB Rel. No. 105-2021-022 (Dec. 14, 2021).
- [4] “Statement On The PCAOB’s 2022 Budget,” SEC Commissioner Allison Herren Lee, December 15, 2021.
- [5] In recent speeches, Gensler and Grewal have signaled that the SEC will prioritize enforcement actions against gatekeepers, such as auditors, and the SEC highlighted five actions in which it charged gatekeepers for failing to meet their obligations. See Press Release, SEC Charges Two Former KPMG Auditors for Improper Professional Conduct During Audit of Not-for-Profit College (Feb. 23, 2021), <https://www.sec.gov/news/press-release/2021-32>. The other four actions mentioned were *In the Matter of Christopher E. Knauth*, *In the Matter of Paul L. Chancey, Jr.*, *SEC v. Rubin and Craft*, and *SEC v. Lawler and Bannister*. See also Speech, Gurbir Grewal, PLI Broker/Dealer Regulation and Enforcement 2021 (Oct. 6, 2021), <https://www.sec.gov/news/speech/grewal-pli-broker-dealer-regulation-and-enforcement-100621>.
- [6] In *re KPMG*, PCAOB Rel. No. 105-2021-008 (Sept. 13, 2021) (KPMG Australia censured, received civil money penalty of \$450,000, and required to undertake certain remedial actions) (The Board took into account the firm’s extraordinary cooperation in the matter, including self-reporting, substantial assistance, and personnel and policy action); *In re Deloitte LLP*, PCAOB Rel. No. 105-2021-104 (Sept. 29, 2021) (Deloitte censured, received a civil money penalty of \$350,000, required the firm to establish, revise or supplement, its quality control policies and procedures); *In re Haskell & White LLP*, PCAOB Rel. No. 105-2021-006 (Aug. 13, 2021) (Firm censured, received civil money penalty of \$20,000, required to establish, revise, and/or supplement existing quality control procedures, and required to provide additional professional education and training *re AS 1215, Audit Documentation*).
- [7] *In re KPMG*, PCAOB Rel. No. 105-2021-008 (Sept. 13, 2021).
- [8] *In re WDM Chartered Professional Accountants and Mike Kao*, PCOAB Rel. No. 105-2021-016 (Sept. 30, 2021) (five-year revocation of WDM’s registration, five-year bar of managing partner, and \$10,000 civil money penalty).
- [9] *In re Haskell & White LLP*, PCAOB Rel. No. 105-2021-006.
- [10] *In re Donald R. Burke, CPA*, PCAOB Rel. No. 105-2021-012 (Sept. 29, 2021) (suspending Burke for one year and imposing a civil money penalty of \$10,000).
- [11] *In re Cheryl L. Gore, CPA and Stanley R. Langston, CPA*, PCAOB Rel. No. 105-2021-020 (Dec. 14, 2021) (one-year limitation of EQR’s activities and \$10,000 civil money penalty).
- [12] *In re Morey, Nee, Buck & Oswald, LLC, John P. Morey, CPA, and Gerard B. Nee, CPA*, PCAOB Rel. No. 105-2021-005 (Aug. 10, 2021); *In re Tamba S. Mayah, CPA and Tamba Seibu Mayah, CPA*, PCAOB Rel. No. 105-2021-007 (Sept. 13, 2021).
- [13] *In re Morgan & Company LLC*, PCAOB Rel. No. 105-2021-002 (March 30, 2021). The Mexican firm audited over 90% of the issuer’s assets.
- [14] See, e.g., *In re KPMG*, PCAOB Rel. No. 105-2021-008 (remedial actions); *In re Deloitte LLP*, PCAOB Rel. No. 105-2021-104 (changes to quality control policies and procedures); *In re Haskell & White LLP*, PCAOB Rel. No. 105-2021-006 (Aug. 13, 2021) (changes to quality control procedures); *In re Ahmed & Associates CPA, P.C. et al.*, PCAOB Rel. No. 105-2020-004; *In re Da Hua CPAs (Special General Partnership)*, PCAOB Rel. No. 105-2020-015; *In re East Asia Sentinel Limited*, PCAOB Rel. No. 105-2020-016; *In re Ruihua Certified Public Accountants*, PCAOB Rel. No. 105-2020-017; *In re Zhonghua Certified Public Accountants LLP*, PCAOB Rel. No. 105-2020-018.
- [15] *In re Slack & Company LLC*, PCAOB Rel. No. 105-2021-017 (Dec. 14, 2021) (censure and \$15,000 civil money penalty); *In re Harbourside CPA LLP*, PCAOB Rel. No. 105-2021-018 (Dec. 14, 2021) (censure, \$10,000 civil money penalty, and remedial measures to establish policies and procedures ensuring future compliance); *In re SS Accounting and Auditing Inc.*, PCAOB Rel. No. 105-2021-019 (Dec. 14, 2021) (censure, \$5,000 civil money penalty, and remedial measures to establish policies and procedures ensuring future compliance).
- [16] *In re Tan Joon Wei*, PCAOB Rel. No. 105-2021-001 (March 29, 2021).
- [17] As depicted in the chart, the percentage of settled orders in 2019 and 2020 is 50% and 53%, respectively. The orders include both firm and individual undertakings, including the required use of an independent consultant, and CPE requirements.

## ABOUT US

Briglia Hundley was founded in 1993 and practices throughout the mid-Atlantic region. Our practice features attorneys who have been listed as “Legal Elite” by Virginia Business magazine, named to Super Lawyers, and listed in Best Lawyers.

We are a forward-thinking law firm that relies upon our experienced and energetic attorneys to reliably and responsibly meet the legal needs of our clients in Virginia, Maryland, and the District of Columbia.

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